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RR RUEHCN  
DE RUEHGZ #0280/01 0960705  
ZNR UUUUU ZZH  
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FM AMCONSUL GUANGZHOU  
TO RUEHC/SECSTATE WASHDC 3693  
RUEHOO/CHINA POSTS COLLECTIVE  
RUEHKO/AMEMBASSY TOKYO 1203  
RUEHUL/AMEMBASSY SEOUL 1416  
RUEHSW/AMEMBASSY BERN 0044  
RUEHGV/USMISSION GENEVA 0422  
RUEAHLH/HOMELAND SECURITY CENTER WASHINGTON DC  
RUCPDO/USDOC WASHDC  
RUEAWJL/DOJ WASHINGTON DC  
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USTR FOR CHINA OFFICE - AWINTER; IPR OFFICE - VESPINEL,  
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E.O. 12958: N/A

TAGS: [KIPR](#) [ECON](#) [ETRD](#) [CH](#)

SUBJECT: China IPR: Better Recognition of the Problem but  
Weak Implementation Hinders Enforcement  
REF: Guangzhou 3874 (notal)

11. (SBU) Summary: It is still common for both domestic and American enterprises to face IPR infringement in South China. Despite increasing recognition of the problem at the provincial and local levels, a lack of training, limited human resources, corruption, and local protectionism continue to result in weak and inconsistent enforcement. End Summary.

12. (U) During a visit to Guangdong in late February, Economic Minister Counselor Robert Luke and Congenoff visited four Chinese and American companies, Guangdong Provincial Intellectual Property Office (IPO), as well as the Economic Crime Investigation Division (ECID) of Shenzhen Police. Interlocutors discussed the IPR protection problems they faced and the causes behind them, and explained their differing protection strategies.

Corporate Reality: IPR Protection Still Not Satisfactory  
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13. (U) Han's Laser Company is a Shenzhen-based high-tech enterprise making laser-manufacturing machinery. It was also the first company enlisted in China's Small & Medium-sized Enterprise Board in Shenzhen Stock Exchange. Han's Laser suffered from IPR infringement when former employees stole its operational software as well as other trade secrets. The company's experience showed that litigations,

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which are usually lengthy and expensive, were not helpful in stopping infringements as counterfeiters could circumvent the penalty by declaring bankruptcy and subsequently opening new companies under other people's names.

¶4. (U) Century Epitech Co. Ltd. is a firm planning to establish a Compound Semi Conductor Industrial Base in Shenzhen. Occupying an area of three square kilometers, the company plans an eventual USD 2.5 billion investment if it is able to attract investors with similar interests to create synergy in the sector. The firm, a creation of Liang Zhiming, former President of the Shenzhen Chamber of Commerce, and a number of investors from Hong Kong and elsewhere in China, reportedly with Shenzhen government encouragement, initially plans to focus on producing energy-efficient lighting, optoelectronics and optical storage, fiber optic communication, and microwave technology. The technology the company plans to utilize will be purchased from Taiwan, Japan and the United States. Acknowledging the need for protecting IPR, company officials did not sound too sure on how to tackle protection issues other than to protect valuable IP via licensing and non-disclosure agreements. They based their main confidence in protecting their IPR in Shenzhen on their close relations with the local government. When asked what they would do if the infringers came from outside of Shenzhen, company officials were lost for an answer. Liang admitted that he had not had success outside of Shenzhen when an uninterrupted power supply (UPS) unit was counterfeited by over 40 enterprises in Shunde, in Guangdong Province's Foshan Prefecture, and Liang was just unable to stop their infringement.

¶5. (U) The American company DAHON, the world's leading folding bicycle manufacturer with a plant in Shenzhen, has been suffering from other companies' copying of its patents

GUANGZHOU 00010280 002 OF 004

and the leaking of trade secrets by former employees. The firm has hired two full-time lawyers to combat the infringements. Company owner and inventor David Hon complained that local police are often not cooperative in handling DAHON's cases. For another American company, Nike, also based in Guangdong Province, brand protection officials pointed out that China still has many "untouchable places," such as Fujian Province's Putian City, where local protectionism and corruption was too strong for Nike to take any substantial measures. In such cases, Nike makes representations to the local and provincial authorities and tracks counterfeit shipments, tipping off a more receptive Customs Bureau to make seizures.

Police: Not Our Priority

¶6. (U) Li Honglang, Deputy Director-General of Shenzhen Public Security Bureau (PSB) and concurrently the Chief of the Bureau's ECID, said that while his Division contributes to the fight against IPR violations, IPR only represents a fraction of his Division's total crime load. IPR crime investigation only accounted for a small portion of the ECID's workload, which totaled 300 cases in 2005. China's laws have over 300 criminal charges, and ECID handles investigation and enforcement for 77 of them, while IPR charges only account for seven of the latter. ECID is responsible for patent and trademark criminal violations, while the PSB's Social Order Division is responsible for criminal copyright cases.

Some Success - Mostly Systematic Failure

¶7. (U) All interlocutors recognized the central and local governments' growing understanding of the importance of IPR, and agreed that the IPR protection environment in China has been improving in recent years, though company representatives still asserted that the counterfeiting

problem is growing at a faster rate than government efforts to stop it. Despite the problem it noted above, Nike Company had a successful year of combating counterfeiting in ¶2005. It recorded 351 seizures involving 500 counterfeiting factories and shoes worth about USD 100 million, while their anti-counterfeiting costs amounted to only 0.6% of this value. Nike representatives pointed out that while this was a good ratio, it was still money that did not produce a profit, it only prevented further damage to the company.

¶8. (SBU) On the other hand, Gao Yunfeng, President of the Han's Laser, believes that it was impossible for the Chinese Government to effectively protect IPR because of China's one-party system. The one-party system excludes the independence of China's justice system, which thus is inevitably vulnerable to manipulation or lobbying by interest groups, such as counterfeiters, especially at lower level governments. Local judges have confirmed that they are often contacted by interested parties, including more senior officials, to influence their decisions (reftel).

¶10. (U) Li Honglang of the ECID said that the valuation threshold in China's IPR criminal prosecution created a

GUANGZHOU 00010280 003 OF 004

large loophole by the undervaluing counterfeits. This enabled government administrative enforcement agencies to not transfer infringement cases to the police for criminal investigation. Li gave a recent example of an IPR case in which Shenzhen's Bao'an District Government refused to transfer an IPR case to the ECID. The District administrative authorities calculated the value of the seized counterfeits at only RMB 290,000 (USD 36,000), lower than the ECID's estimated value of RMB 300,000 (USD 37,300), the criminal threshold, even though both sides are supposed to assess the counterfeits by their market value.

¶11. (U) Huang Guoqiang, a deputy director general of the Guangdong IPO, admitted that the IPO basically only focused on the patent part of IPR protection and its development despite having a coordination role. The IPO only plays a coordination role in interagency cooperation, especially during major campaigns involving joint action. On a day-to-day level, each agency acts on its own priorities.

¶12. (U) Gao mentioned that most Chinese police at the working level are very cautious in avoiding the risk of a misjudgment in patent disputes because they lack sufficient technological expertise in understanding patents. David Hon, General Manager of DAHON, also pointed out the Chinese traditional culture of "sympathizing with the poor and hating the rich" weakened the police's willingness to protect the "rich" IPR rights holders. Both rights holders and enforcers said that IPR awareness of Chinese public was still low and most people did not feel it wrong to buy counterfeits.

Different strategies

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¶13. (U) Han's Laser now adopts a protection as well as a competition strategy of rapid launching of new machine models that make it difficult for counterfeiters to follow. DAHON will continue the direct combating of infringements through legal means. Both Han's Laser and DAHON will continue to try to lower the risk of trade secret leakage by increasing the salary for their engineers and having them sign non-disclosure and non-compete agreements. Nike is expanding its brand protection staff size and will continue to maintain its close partnership with local enforcement agencies, such as local Customs and AIC, which guarantees their success. Nike generally uses administrative enforcement cases as a starting point and takes the decision against the counterfeiter to civil court to seek damages, a strategy which it feels has been quite successful, though it does not shut counterfeiters down. Century Epitec will

continue to focus its efforts on improving relations with local government, though hopefully it will begin to consider protection strategies for cases that go beyond Shenzhen.

¶14. (U) As counterfeiting criminals are getting more specialized in their manufacturing chain and subdividing the manufacturing functions to lower the likelihood of getting caught, Shenzhen Police will pay more attention to clearing the criminal networks at multiple levels through the use of simultaneous actions. The police have a regulation that generally links landlords' criminal liabilities with their

GUANGZHOU 00010280 004 OF 004

tenants' criminal activities, but not specifically with distribution or retailing of pirated products. Guangdong IPO will continue its education and training programs for the public, especially aimed at primary students and local enterprises, and is beginning to place a priority on protecting IPR in trade fairs or exhibitions now that new trade fair regulations have come out in draft. Both the IPO and Shenzhen Police welcome the USG's suggestions and cooperation in IPR work and are willing to support a USG program to teach American enterprises how to use Chinese judicial to protect their IP.

Comment

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¶15. (U) Despite the Chinese Government's growing efforts and understanding of the significance of protecting IPR, the effectiveness of the protection of IPR remain problematic and relies on individual enterprises' relations of with individual local governments. Local protectionism and corruption remain the major barriers for protection. As an interlocutor pointed out, "it still has a very long way to go." End comment.

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